

- c) render an opinion on whether the joint cost allocation results fairly present, in all material respects, the results of the company's regulated and nonregulated operations;" and
- d) evaluate and report on the carrier's internal controls when auditors rely upon those controls in determining the extent of auditing procedures as required by Generally Accepted Auditing Standards.

5. Performance of on-site audits by the FCC staff.¹⁰

The affiliate transaction and cost allocation rules and safeguards have been tested and affirmed through numerous FCC orders and actual use for over eight years. The current affiliate transaction rules and safeguards were deemed adequate by the FCC in 1987,¹¹ refined in the various CAM approval orders issued in 1988 and subsequent years,¹² and reaffirmed as working well in 1991 in the conclusion reached in the BOC Safeguards Order.¹³

As noted above, the accounting safeguards contain specific independent audit requirements with respect to the carriers' compliance with the joint cost rules and the proper allocation of costs to regulated services and nonregulated activities. In my opinion, the independent audits have been a highly effective tool. My own experience

⁹ Id. at 7581-82.

¹⁰ Id. at 7591 and 7594.

¹¹ Joint Cost Order, supra note 3, at 1335-1337; Joint Cost Recon. Order, 2 FCC Rcd at 6293-6298.

¹² See, e.g., In the Matter of NYNEX Telephone Companies' Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, 3 FCC Rcd 81 (1988). (NYNEX CAM Approval Order); In the Matter of U S WEST's Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, 3 FCC Rcd 195, 199 (1988). (U S WEST CAM Approval Order). The Common Carrier Bureau reviewed and issued orders on each cost allocation manual filed.

¹³ BOC Safeguards Order, supra note 2, at 7594-7595

has been that most of the cases of potential non-compliance with the joint cost rules which have been addressed by the FCC were first identified during the independent audits. Many of these involved interpretations of FCC rules and relevant facts and positions were documented for the FCC staff's consideration and resolution during the course of its review of the independent audits.

ACCOUNTING FOR PAST ASSET RECLASSIFICATIONS UNDER THE APPLICABLE FCC ORDERS

A. CC Docket No. 86-111 , "Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities"

The cost allocation rules required by CI-III were addressed in CC Docket No. 86-111. As noted in the NPRM, paragraph 170 of the Joint Cost Order states that "If reallocations of telecommunications plant (i.e , central office equipment and outside plant) from regulated to nonregulated operations are required, such plant will be reclassified at undepreciated baseline cost plus an interest charge to reflect the time value of money." Baseline cost, in this instance, would represent "the depreciated original cost at the time of the initial assignment or allocation of existing plant or the original cost of subsequently acquired new plant." In the matter of pay telephone assets being reclassified as nonregulated assets pursuant to Section 276 of the Act, the proper interpretation of the above standard would be that the time of initial assignment to nonregulated would be the effective date of reclassification as mandated by the FCC in CC Docket No. 96-128. In other words, the interest charge parameter noted above would not apply as payphone assets were properly classified as regulated per FCC Rules and

Regulations prior to enactment of Section 276 of the Act and will be properly classified as nonregulated upon implementation of Section 276

There were two reasons given in the Joint Cost Order for the application of an interest component: (1) to compensate the regulated operation for the time value of the costs it bore for the nonregulated operation, and (2) to overcome the incentive for the carrier to underestimate its future nonregulated demand to avoid committing plant capacity to the nonregulated operation. Neither of these reasons is applicable to this initial segregation of assets - up until now there have been no nonregulated payphone operations and there have been no estimates to understate.

In addition, rules governing the reclassification of assets between affiliates as prescribed in CC Docket No. 86-111 are codified in Section 32.27 of the Uniform System of Accounts ("USOA"). Section 32.27 requires that "Assets sold or transferred from the regulated accounts to affiliates shall be recorded as operating revenues, incidental revenues or asset retirements according to the nature of the transaction involved. If such sales are reflected in tariffs on file with a regulatory commission or in a prevailing price held out to the general public, the associated revenues shall be recorded at the prices contained therein in the appropriate revenue accounts. If no tariff or prevailing price list is applicable, the proceeds from such sales shall be determined at the higher of cost less all applicable valuation reserves, or estimated fair market value of the asset." In the above context, "affiliates" include both structurally separate nonregulated affiliates and

nonregulated activities conducted by the carrier for which a separate set of books is maintained.

B. CC Docket No. 81-893 and File No. ENF 83-18, "American Telephone and Telegraph Company, Request for Approval To Supplement the Capitalization of AT&T Information Systems in Connection with the Transfers of Embedded Customer Premises Equipment"

In CC Docket No. 81-893, the FCC addressed the transfer of embedded customer premise equipment ("CPE") from AT&T to AT&T Information Systems ("ATTIS") and determined that the "net book value of embedded CPE should be used as a surrogate for economic value for purposes of establishing sale prices and valuing the equipment to be transferred to ATTIS." The FCC went on to define economic value as "the price a carrier would be willing to pay for its CPE if, instead of owning it, the carrier had the opportunity to purchase it."

In each instance cited above, the FCC has prescribed a net book value standard as being either the proper standard for reclassification of CPE related assets, a viable surrogate for fair market value, or a conservative alternative to fair value assuming that the net book value of assets reclassified is greater than market.

ACCOUNTING FOR ASSET RECLASSIFICATIONS UNDER GAAP

GAAP provides for similar accounting treatment when a reclassification involves affiliated entities. In the asset reclassifications contemplated above, the payphone assets would represent a reclassification from one entity (BOC) to another entity (either a

nonregulated activity or a separate subsidiary) Each of these entities is under the common control of the BOC's holding company

Accounting Interpretation No. 39, "Transfers and Exchanges Between Companies Under Common Control" of Accounting Principles Board ("APB") Opinion No. 16, "Business Combinations," requires that transfers of assets between entities under common control "would be accounted for at historical cost in a manner similar to that in pooling of interests accounting."

OUR OPINION ON APPROPRIATE ACCOUNTING FOR PAYPHONE ASSET RECLASSIFICATIONS

An integral part of the deregulation of the payphone line of business will be the reclassification of previously regulated assets to the new nonregulated pay telephone business. The value of these assets has been established through the regulatory process, as required by Part 32 accounting, depreciation requirements and rate proceedings. The incumbent BOCs must be allowed to seamlessly reclassify these existing assets to their nonregulated payphone operations using the most appropriate and consistent asset valuation methodology, which is net book value. The use of net book valuation has the same benefits as characterized in previous orders, the most obvious of which is a standard valuation method that can be consistently applied by all carriers with consistent results.

In summary, we agree with the FCC's conclusion in paragraph 49 of the NPRM that the appropriate basis of valuation for the reclassification of payphone equipment to

nonregulated status should be the assets' original cost, less associated reserves for accumulated depreciation, accumulated deferred income taxes and unamortized investment tax credits. This conclusion is consistent with prior FCC orders and GAAP. Such valuation should be limited to the specific tangible assets reclassified to the BOC public communications businesses. Creating intangible assets as a result of an asset reclassification between two affiliated entities has never been required or allowed in any FCC proceeding. Therefore, we believe that the asset reclassification amounts, consistent with prior practice, should be limited to tangible assets. This is the most equitable approach, reflects the economic substance of the reclassification, and will allow the BOC public communications businesses to compete on equal terms with the independent payphone providers without being saddled with higher than market value payphone assets.

Attached as Exhibit C is my curriculum vitae.

ARTHUR ANDERSEN LLP

A handwritten signature in cursive script that reads "Carl R. Geppert / me".

by
Carl R. Geppert

Calculation of Market-Based PCC
Analysis of ATT Tariffs

Exhibit A

	<u>Service Charge</u>	<u>Initial Period</u>	<u>Additional Periods</u>	<u>Total Revenue</u>	<u>Commission</u>
Calling Card Calls					
<u>Lowest (1 - 10 Miles)</u>					
Day	\$0.80	\$0.32	\$0.27	\$1.73	\$0.62
Evening	0.80	0.25	0.20	1.50	0.54
Night/Weekend	0.80	0.22	0.17	1.40	0.50
<u>Average (293 - 430 Miles)</u>					
Day	\$0.80	\$0.39	\$0.34	\$1.96	\$0.71
Evening	0.80	0.28	0.23	1.60	0.58
Night/Weekend	0.80	0.25	0.20	1.50	0.54
<u>Highest (4,251 - 5,750 Miles)</u>					
Day	\$0.80	\$0.43	\$0.38	\$2.09	\$0.75
Evening	0.80	0.33	0.28	1.76	0.63
Night/Weekend	0.80	0.28	0.23	1.60	0.58
Collect Calls					
<u>Lowest (1 - 10 Miles)</u>					
Day	\$2.25	\$0.32	\$0.27	\$3.18	\$1.14
Evening	2.25	0.25	0.20	2.95	1.06
Night/Weekend	2.25	0.22	0.17	2.85	1.03
<u>Average (293 - 430 Miles)</u>					
Day	\$2.25	\$0.39	\$0.34	\$3.41	\$1.23
Evening	2.25	0.28	0.23	3.05	1.10
Night/Weekend	2.25	0.25	0.20	2.95	1.06
<u>Highest (4,251 - 5,750 Miles)</u>					
Day	\$2.25	\$0.43	\$0.38	\$3.54	\$1.27
Evening	2.25	0.33	0.28	3.21	1.16
Night/Weekend	2.25	0.28	0.23	3.05	1.10

Calculation of Market-Based PCC
Analysis of Specific IPP's (1995)

Exhibit B

Communications Central, Inc.

Average Pay Stations	23,230
Total Non-Coin Compensation	\$47,951,000
Average Non-Coin Compensation Per Station	\$2,064
Average Non-Coin Calls Per Station	1,953
Average Non-Coin Compensation Per Call	\$1.06

Davel Communications Group, Inc.

Average Pay Stations	9,756
Total Non-Coin Compensation	\$15,811,000
Average Non-Coin Compensation Per Station	\$1,621
Average Non-Coin Calls Per Station	1,953
Average Non-Coin Compensation Per Call	\$0.83

Peoples Telephone Company, Inc.

Average Pay Stations	42,116
Total Non-Coin Compensation	\$59,923,303
Average Compensation Per Station	\$1,423
Average Non-Coin Calls Per Station	1,953
Average Compensation Per Call	\$0.73

Consolidated

Total Pay Stations	75,102
Total Non-Coin Compensation	\$123,685,303
Average Compensation Per Station	\$1,647
Average Non-Coin Calls Per Station	1,953
Average Compensation Per Call	\$0.84

CARL R. GEPPERT

CURRICULUM VITAE

RELEVANT SKILLS AND EXPERIENCE

Carl is a partner in the Chicago office of Arthur Andersen. He has over 15 years of experience in assisting telecommunications companies in addressing significant financial, regulatory and business issues. Carl's experience includes:

- Directs our Firm's telecommunications industry training program and develops and conducts training seminars on the regulatory accounting process, accounting for income taxes, the rate case process and service cost concepts for telecommunications industry personnel. Has instructed over 100 training seminars in the telecommunications industry.
- Directs our Firm's Part 64 audit activities and developed our Firmwide approach to Part 64 cost allocation audits including the use of statistical sampling in the audit process. Serves as our Firm's primary interface with the Federal Communications Commission (FCC) in addressing Part 64 and related regulatory issues. Serves as Part 64 audit engagement partner at Ameritech and advisory partner on our Part 64 audits at US West, GTE, Alltel and SNET. Has conducted special seminars regarding the Part 64 Rules and audit requirements for the FCC Accounting and Audits Branch and for several audit and non-audit clients.
- Consults regularly with telecommunications clients of all sizes regarding regulatory and costing matters, including issues involving the proper application of the Part 32 Uniform System of Accounts and the Part 64 Cost Allocation Rules. Consults extensively on the design, implementation and audit of systems and procedures for Part 64 cost allocations between regulated services and nonregulated activities and compliance with the Part 32 regulatory accounting, affiliate transaction, cost capitalization and property record requirements.
- Planning and directing financial and other special audits for clients of all sizes. Serves as the overall audit engagement partner for our financial statement audits at Ameritech's regulated telephone companies, including Ameritech Pay Phone Services, and several of Ameritech's nonregulated subsidiaries and Part 64 cost allocation audit work at Ameritech Corporation and subsidiaries.

- Significant regulatory consulting, including extensive involvement in rate filings by reviewing forecasted data, analyzing historical data and developing and reviewing expert testimony on a variety of accounting, cost allocation and tax issues. Developed a P C -based Pricing Analysis Tool to assist companies evaluate alternative regulatory strategies at the Federal and state levels.
- Directing process reengineering efforts at local exchange carriers, including reengineering projects in the finance area which resulted in significant process efficiencies and cost savings in the areas of accounts receivable, accounts payable, treasury, corporate accounting, payroll, centralized mail remittance, taxes, regulatory and property and cost accounting.
- Performing billing certification examinations for local exchange carriers in conjunction with AT&T's future optimum state/supplier quality certification initiatives and special audits mandated by the FCC related to the reconciliation of special access billing records and engineering records and NECA common line adjustments.
- Consultation on local exchange carrier internal control procedures and operating efficiencies in the areas of customer billing, carrier access billing, purchased accounts receivable and settlement processing.

REPRESENTATIVE CLIENTS

Ameritech	ATU Telecommunications
Bell Atlantic	Alltel
BellSouth	Citizens Utilities
NYNEX	GTE
Pacific Telesis	SNET
SBC Communications	Sprint
US West	United States Telephone Association

EDUCATIONAL AND PROFESSIONAL BACKGROUND

Carl holds Bachelor and Master of Science degrees in accounting from the University of Illinois. He is a member of the American Institute of Certified Public Accountants, Illinois CPA Society and the Accounting and Tax Committee of the Illinois Telephone Association.

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